CalPERS

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February 18, 2009

AGENDA ITEM 3

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: State Legislative Proposal: Inactive Member Distributions

II. PROGRAM: Legislation

III. RECOMMENDATION: Staff recommends that the Board **sponsor** legislation to specifically authorize the refunding of accumulated contributions to members when they reach 70 years of age.

IV. ANALYSIS:

Currently, CalPERS lacks clear statutory authority to refund contributions to inactive members who have reached age 70 without a signed election from the member. In some cases, CalPERS has had difficulty contacting the member to obtain this authorization. However, allowing such inactive members to leave the funds on deposit after age 70 risks tax penalties for the member and could cause CalPERS to be out of compliance with Internal Revenue Code requirements. This legislation also makes certain changes to existing language in order to clarify the provision's original intent.

Background

Under current state law when a member separates from all CalPERS covered employment and is not an active member of another California public retirement system, he/she may elect a refund of his or her retirement contribution account. Or, if the separated member is vested, he/she may apply for service retirement upon reaching age 50. At the time of separation from employment, a package is sent to the member describing the alternatives available such as electing a refund, leaving the money on deposit and applying for retirement upon reaching age 50 (if vested), or applying for retirement immediately if vested and at least age 50.

If a refund of member contributions is elected and issued, membership in the system is terminated and the member has no rights to future retirement, health, and disability benefits. An election to refund is a serious decision that requires an active choice on the part of the member to initiate the process. It also requires a spousal signature and the member must initial a "waiver of rights" indicating that they understand the consequences of the decision they are making. If a member takes no action, his or her contributions remain on deposit with CalPERS earning interest at 6 percent.

Federal law requires that inactive members receive a required minimum distribution by April 1 of the calendar year after they reach age 70 ½. This law guarantees that assets cannot remain permanently sheltered from taxation. To comply with minimum distribution requirements, CalPERS annually informs members of the need to withdraw their contributions, or apply for retirement if vested, by or before reaching age 70 ½. Because CalPERS' current authority does not allow CalPERS to make incremental distributions to non-vested inactive members, the account must be refunded in full unless the member applies for retirement. When the refund is issued, CalPERS makes the necessary tax payments to the IRS and Franchise Tax Board.

Proposed Changes

This proposal would make the following changes in existing law:

1. Specifies that inactive members who have attained age 70 will be provided with an election form to take a refund of their retirement contribution account or apply for retirement, if vested.

2. Declares that failure to make an election within 90 days of the notice would be considered an election to withdraw.

3. Directs that, if the person cannot be located, CalPERS may proceed as if an election to withdraw the inactive member's contributions was received. Their distribution will be administered in accordance to section 21500, which specifies that the refund be issued to a non interest- bearing unclaimed benefit account until the member can be located.

Legislative History

1990	Chapter 1544 (SB 2470, Green) – Provided that members who permanently separate from CalPERS-covered employment regardless of years of service, have the right to keep their contributions on deposit. *CalPERS' position: Support*

Discussion

CalPERS goes to great lengths to keep members aware of their options regarding their retirement accounts. In addition to the packets sent when members separate, they are mailed an annual member statement giving them a summary of their accounts. Starting at age 45, this statement also includes a retirement estimate for members who will be vested by age 50. CalPERS also notifies members as they are approaching the age limit for the RMD that they may request a refund or apply for retirement, if vested. However, if a member does not update his or her address, these notifications may not be received. Staff makes every effort to independently identify the correct address, including checking against Social Security's database and other government records, but if no current address is on file, CalPERS has no way of contacting the member. This proposal specifically authorizes CalPERS to distribute a 70 year-old member's accumulated contributions and avoids the potential consequence of a member incurring a 50 percent penalty from the IRS if funds are not distributed before April 1 of the calendar year following age 70 ½. The proposed change facilitates CalPERS' compliance with the IRS' minimum distribution requirements.

V. STRATEGIC PLAN:

This proposal addresses CalPERS strategic objective to provide sustainable pension benefits and services responsive to, and valued by, members, employers, and stakeholders, and to administer benefits in a cost-effective manner.

VI. RESULTS/COSTS:

This proposal would allow CalPERS to be in compliance with the Internal Revenue Code by addressing the issues relating to non-responsive inactive members while protecting their financial interests.

Program Costs

This proposal would reduce costs to inactive members by avoiding potential tax penalties on members who do not receive a distribution or refund of contributions by age 70 ½.

Administrative Costs

None identified. However, slight administrative savings could be realized by reducing the workload to obtain an election from the member.

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